

# **Making A Market**

## **Cannabis Legalization Recommendations for Governor Newsom**

***February 21, 2019***

### **Overview**

Two years after California voters legalized recreational marijuana, implementation of the complex initiative is faltering, with major implications for the state's environment, economy, and consumers. Only a small fraction of California's cities and counties have licensed the operation of cannabis businesses. Enforcement is challenging and taxes high, so cultivators, dispensaries, manufacturers, and distributors lack incentive to comply. The illicit market thrives, anticipated tax revenue has yet to materialize, and black market growers exploiting public lands continue to divert streams and poison wildlife.

What can California do immediately to move beyond these early struggles and establish a well-regulated, equitable, and sustainable market for recreational cannabis?

On January 22, Resources Legacy Fund convened a small group of experts to discuss barriers and solutions to implementation of the 2016 ballot measure that legalized recreational cannabis. Together, these representatives of cannabis industry associations, small growers, nonprofits, and local governments discussed a range of recommendations for Governor Newsom's administration. This document provides a synthesis of that discussion, and these recommendations were supported by a majority of the meeting participants.

The recommendations include simplifying permitting, bringing down initial legalization costs with a state revolving loan program, and changing the tax code to allow deductions for cannabis business expenses. The group also identified catalytic investment of approximately \$400 million in one-time general funds over the next three years that could incentivize participation by both cities and counties that have not permitted cannabis and the majority of cannabis businesses that are not converting to legal operation.

### **Background**

The California cannabis industry involves an estimated 50,000 operations and \$5 billion in annual profit.<sup>1</sup> California produces 13.5 million pounds of cannabis annually while Californians consume 2.5 million pounds of cannabis.<sup>2</sup> Since the passage of Proposition 64 in November 2016, less than 10 percent of cannabis businesses have been licensed by state agencies. Tax revenue is currently at only half of Governor Brown's estimate of \$650 million for 2018. Without significant changes, California's legal industry will continue to be dwarfed by the illicit trade and the myriad problems created by unregulated cannabis activities will continue. More effort and new approaches are needed to accelerate participation in the legal cannabis industry; ensure high standards for public health, safety, and environmental protection; shut down harmful illegal operations; remediate environmental damage; and promote equitable business growth.

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<sup>1</sup> Cannabis Advisory Committee 2018 Annual Report. Bureau of Cannabis Control. 2019. Page 3.

<sup>2</sup> Cultivation Program Regulations Standardized Regulatory Impact Assessment. Prepared by ERA Economics, LLC for the California Department of Food and Agriculture Medical Cannabis Cultivation Program. January 27, 2017.

## Policy Recommendations

### 1. Maximize number of local jurisdictions permitting legalized cannabis

Two out of three local jurisdictions in California have not yet permitted cannabis operations and an estimated 20 million Californians cannot conveniently access legal cannabis. For a variety of political, ideological, and practical reasons, many cities and counties remain reluctant to permit operations, even where illegal cannabis activities are prevalent. Smaller jurisdictions may lack adequate staff to develop cannabis programs and implement state agency requirements. Of jurisdictions that have legalized cannabis, many rely on contractors rather than full-time staff to navigate unfamiliar state regulations. With direct incentives and technical support, the state could help increase the number of jurisdictions participating in legalization.

- *Recommendation:* Reduce barriers to entry and create incentives for bringing new jurisdictions into legalization.
  - Provide annual local law enforcement grants to police and sheriff departments in jurisdictions that permit cannabis businesses.
  - Make state grants and loans available to jurisdictions to establish cannabis regulatory programs.
  - Establish technical assistance programs for cities and counties that have legalized cannabis but struggle with program implementation.<sup>3</sup>
  - Direct the Secretary of the California Department of Food and Agriculture to allow local Fair Boards discretion to allow cannabis activities on fair grounds including leasing to cannabis businesses.

### 2. Enhance state agency collaboration and coordination and simplify permitting

California's three cannabis regulatory agencies, California Department of Food and Agriculture, California Department of Public Health, and Bureau of Cannabis Control, have separate and sometimes contradictory permit requirements, creating a confusing and burdensome legalization process for cannabis operators. Similarly, California Department of Fish and Wildlife, CalCannabis, and State Water Resources Control Board regulations can be difficult for applicants to understand and follow. The cost of complying with procedural requirements may inhibit some cities and counties from adopting cannabis regulatory ordinances.

- *Recommendation:* Consider appointing a cannabis director in Office of the Governor to coordinate cannabis policy for the State.
- *Recommendation:* Reduce duplication and conflict among state agency permit requirements while retaining protections for public health, safety, and the environment.
- *Recommendation:* Appoint a state liaison to help applicants navigate permitting requirements across state agencies.
- *Recommendation:* Evaluate the potential utility of a single online portal to ease access to all required state permits.
- *Recommendation:* Extend current temporary California Environmental Quality Act exemption for cities and counties adopting cannabis ordinances from July 1, 2019

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<sup>3</sup> See for example: [CivicSpark Program](#) hosted by the Local Government Commission and Office of Planning and Research which recruits 90 Fellows annually who serve with local governments for 11 months implementing sustainability projects.

until July 1, 2022 to allow additional local jurisdictions to benefit from this exemption.

- *Recommendation:* Evaluate the Oregon model to allow batch testing of certain cannabis products if public safety would not be compromised, to reduce bottlenecks getting product to market.
- *Recommendation:* Raise monetary value limits for cannabis deliveries (currently capped at \$3,000) to the \$10,000 limit, as defined repeatedly in the preliminary and emergency cannabis regulations.
- *Recommendation:* Make cannabis industry participants eligible for state-funded agricultural programs such as the Williamson Act, the Healthy Soils Program, and State Water Efficiency and Enhancement Program.

### 3. Phase legalization costs and fully promote equity programs

Cannabis operators face tens of thousands of dollars in fees and permits associated with legalization. Unlike other business owners, they cannot apply for loans and other banking services. This creates a *de facto* barrier to entry for small operations and discourages legalization. In addition, cannabis business involvement does not reflect California's demographic diversity, in part due to the effects of decades of discriminatory drug policies that have disproportionately affected communities of color.

- *Recommendation:* Develop a revolving loan program using initial state investments to spur small or minority-owned business growth, in which legalized businesses would pay into an industry-sponsored finance mechanism to fund startup of new businesses.<sup>4</sup>
- *Recommendation:* Provide increased state funding for equity programs that support diverse perspectives and participation in the cannabis industry, consistent with SB 1294. Acknowledge historical barriers to entry and promote best practices.

### 4. Tax reform

Legal cannabis operators are being taxed up to 40 percent of total profit through a combination of state and local taxes, annual fees, compliance permits, and business licensing requirements, putting them at severe disadvantage to illicit cannabis competitors who face none of these costs.<sup>5</sup>

- *Recommendation:* Evaluate the efficacy of a revenue-neutral tiered taxation scheme based on the cumulative square footage cultivated by each licensed grower. This policy could provide a tax reduction and/or exemption to a vast majority of cottage, specialty, and small growers.
- *Recommendation:* Allow deductions of cannabis business expenses under the California tax code to encourage infrastructure investments and legalization.
- *Recommendation:* Create additional tax incentives for cannabis businesses implementing specific environmentally beneficial practices.

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<sup>4</sup> See for example the Clean Water Act State Revolving Fund.

<sup>5</sup> Note that changes to state tax levels would require amendment to Proposition 64's Revenue and Taxation Code Section 34012(a)(2).

## 5. Prioritize enforcement based on risk of harm

As cannabis operators submit applications and move toward legal compliance, enforcement agencies should prioritize those operators who undermine legalization and present significant public health, safety, or environmental risks.

- *Recommendation:* Create tiered levels of enforcement, prioritizing operations that directly threaten human health and safety, public resources, and the environment.

## 6. Support cannabis research, comprehensive and transparent data collection, and effective information dissemination

The absence of reliable and accurate information may reinforce unfounded concerns about legalization among local jurisdictions, and consumers may not understand the benefits of choosing legal product over contraband. State regulatory agencies lack a strategic and coordinated approach to educating local governments and the public about scientific research, public health and environmental impacts, and the risks associated with purchasing illegal, untested product.

- *Recommendation:* Fund cannabis industry research and communicate data and findings to better educate the public and local policymakers about the legal and illegal cannabis markets and products.
- *Recommendation:* Support standardized data collection across state agencies, local governments, and industry members to increase transparency, improve understanding, and promote adaptive management.

## 7. Access to banking

Since cannabis has not been decriminalized at the federal level, cannabis operations cannot access traditional banking, loans, or other financial resources. Together, the growing number of states that have legalized cannabis may be able to influence federal access to financing.

- *Recommendation:* Align with other states to seek federal allowance of cannabis industry banking.

## **January 22, 2019 Meeting Participants**

Hezekiah Allen (Emerald Grown), Matt Clifford (Trout Unlimited), Hollie Hall (Compliant Farms Certified), Lindsay Robinson (California Cannabis Industry Association), Eric Sklar (FUMÉ), Nicole Elliot (formerly with City of San Francisco), Samantha Campbell (Campbell Foundation). Organizational affiliations listed for identification purposes only.

Convener: Resources Legacy Fund

Facilitator: Darrell Steinberg (Mayor of Sacramento, not acting in his mayoral capacity)

## **Recommended State Investments 2019-2022**

Participants agreed that an immediate, significant state investment would help jump-start a robust legal cannabis market in California. The conceptual funding strategy below totals \$400 million over three years and reflects the types of investments that participants identified as needed.

### **1) Enforcement**

- \$120 million (\$40 million/year) – Local Law Enforcement
  - Support grants to local enforcement with the goal of encouraging sheriff/police and other local officials to support establishing a legal cannabis market in their jurisdictions. Funds would only be allocated to police and sheriff departments in jurisdictions with permitting system in place to allow legalized cannabis.

### **2) Capacity and Technical Assistance**

- \$48m (\$16m/year) – Technical Assistance
  - Support technical assistance to improve state and local jurisdiction collaboration by adding state advisors to help local jurisdictions establish cannabis programs and liaisons to help applicants navigate state permitting system.
- \$50m (\$16.6m/year) – Revolving Loan Program
  - Capitalize revolving loan program to help small and minority owned businesses with start-up costs associated with permitting.
- \$20m (\$6.7/year) – Equity Programs
  - Support equity programs to help local jurisdictions develop and implement programs to ensure diverse participation in legal cannabis industry.
- \$30m (\$10m/year) – Research and Communications
  - Support research & communication priorities to examine connections between cannabis and public health and safety and environment and to promote objective, fact-based, cannabis education, outreach, and transparency.
  - Implement standardized data collection from local jurisdictions to state agencies.

### **3) Environment**

- \$45m (\$15m/year) – Cannabis Restoration Grant Program
  - Support restoration of watersheds impacted by cannabis cultivation.
- \$45m (\$15m/year) – Watershed Coordination
  - Support Department of Conservation watershed coordination program in areas impacted by cannabis.
- \$30m (\$10m/year) to Department of Conservation
  - Provide state subvention funding to help local governments finance deferred Williamson Act payments for properties with permitted cannabis operations in full compliance with state and local regulations.
- \$10m (\$3.3m/year) - Programmatic Environmental Impact Report
  - Develop programmatic environmental review at a regional level to promote more efficient and landscape scale review.
- \$2m (\$.66m/year) – Public Utilities Commission/California Energy Commission
  - Fund a study of energy supply and demand for the cannabis industry, cannabis energy growth demand projections, and development and dissemination of best management practices.